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ABSTRACT

The paper shows, with publicly available numeric data and their graphs, the high correlation of the federal funds rate (FFR) with recessions, GDP variations, and unemployment rate. The evidence from these graphs and the analysis of existing literature show how by arbitrarily changing the FFR, the Federal Reserve can control the entire economy. We explain, using the law of conservation, how the Federal Reserve can transfer wealth from the bottom fifth to the upper economic classes and expand the poverty and misery in the society. This research demonstrates that the poverty is the result of manmade design of the economy and is not a natural phenomenon. Finally we explain the design and implementation of an alternative to the Federal Reserve Bank, called the moneyless economy, which eliminates permanently the deficit, debt, taxation, unemployment, and poverty from the world.

Keywords

GDP, Macroeconomic Time Series, Wealth, Employment data, Funds

1 INTRODUCTION

Assume that the total material wealth of a nation is equivalent to a pot of gold. That is, this gold represents all the automobiles, airplanes, missiles, roads, bridges etc., or in other words this is the GDP, the gross domestic product. Similarly assume that the total money available is a bag of dollar bills. This is the equivalent of the largest monetary aggregate (M3) or the total money in the economy. This bag of money has an one to one relationship with this pot of gold. This bag of money can buy that pot of gold.

By the law of conservation (LOC) this pot of gold cannot grow. This law says that the mass and energy cannot be created or destroyed; it can only be transformed from one form to another form. This bag of money cannot grow either, because this is equivalent to that pot of gold and is attached to it by the LOC.

We all know that the Fed can print another bag of money, out of thin air. It is a private bank and only it can print money without any restrictions, transparency, and accountability to anyone. Money is free for the Fed and it can give it to anyone it chooses, as we point out later.

This extra bag doubles the price of the pot of gold causing inflation. If this money is allocated only to the top fifth of the population then their share of the pot of gold will increase, changing the wealth distribution. According to the LOC, since the gold cannot increase, the share of the bottom fifth will then naturally decrease causing transfer of wealth. This transfer of wealth happens not only because the money share decreases for the bottom fifth, the price of gold also increases, and thus reducing their purchasing power.

According to the LOC there cannot exist a win-win situation. When someone wins, someone else must lose. In every win-win situation, a detailed analysis will always show that there is a third party who will be the loser. Thus the LOC says that the transfer of wealth must happen when someone becomes richer.

Printing money is not the only way to transfer wealth, the profiting and the interest charging, are also ways of transferring wealth. We explain this phenomenon in details in this paper. The capitalism is precisely designed to make that transfer happen. Wealth transfer happens only when you make money without contributing to the pot of gold or to the GDP. Thus stock market gain is a way to transfer wealth. In fact the entire financial system is a means to transfer wealth. That is because the financial system can redistribute the quantity money.

At the heart of capitalism is the central bank, which is The Federal Reserve Bank in USA, and commonly known as The Fed. The main purpose of the capitalism, is to transfer wealth, as clearly stated by the US President Abraham Lincoln (1861-1865) - "Corporations have been enthroned, an era of corruption will follow, and the money power of the country will endeavor to prolong its reign by working upon the prejudices of the people, until the wealth is aggregated in a few hands, and the republic is destroyed (Grint, 2005)." Milton Friedman, the Nobel laureate in economics, said that the US recession of 1930s was created by the central bank (Skarica, 2011). We show that the recession is the most powerful mechanism for the bulk transfer of wealth. Our recent experience of economic crash in 2008, and the analysis of our public data shows that the above conclusions by Lincoln and by Milton are very legitimate and real even in our present times.

The rest of the paper is organized in the following way. In Section 2 we describe how we modified the raw data to make it suitable for comparison. In Section 3 we describe, using a block diagram, how the economy can be controlled by the Fed. Then in Sections 4 through 6 we show how the FFR plays the key role in controlling the GDP, unemployment, and the income of the bottom fifth of the population. In Section 7 we discuss how the lack of transparency of the Fed prevents evaluation of inflation. Finally we describe the moneyless economy to remove poverty from the world.

2 NOTES ON DATA PROCESSING

We have normalized all the data elements between -1 and +1 by dividing the raw data by the maximum of the absolute value of the raw data. We then replaced this raw data by this normalized data. Mathematically speaking this means:

$$mx = \max_i |d_i|, \quad d_i = \frac{d_i}{mx}, \quad i = 1..N, \quad N = length\ of\ data$$

This approach helps to compare the characteristics of the graph rather than the magnitude of the data. This approach also allowed us to plot multiple graphs on same y-scale. We believe this normalization helped us to identify the correlation by visual inspection of the graphs.

We have also used the correlation (Taghizadeh, 2000) as a measure to determine the relationship between two time functions. The following correlation formula was used:

$$cor = \frac{\sum_{i=1}^{N} f_i g_i}{\sqrt{(\sum_{i=1}^{N} f_i^2)(\sum_{i=1}^{N} g_i^2)}}$$

In the formula $\{f_i\}$ and $\{g_i\}$ are two time series data arrays. The above formula shows that the absolute value of the correlation number, cor, cannot be greater than 1. It is also clear that if f and g are same then the correlation number will be 1. Thus closer the value to one better is the similarity between the two time functions.

In addition, we have also used simple linear operations on the data. These are like introducing delay or lag, scaling, reflection, shifting left or right etc. This helps to mathematically show the correlation of the variables. We have avoided more than one delay operation over the entire time period to keep it simple at the cost of achieving lower correlation values.

It is always possible to manipulate data in many different ways. For example, we could consider the fund rate data as an input function to a set of simultaneous difference equations, similar to vector auto regression (VAR), with multiple state variables representing various economic parameters. Then we could combine these state variables using another set of simultaneous algebraic equations to produce unemployment data for example. You can see such an approach in the paper (Bernanke, 1992). Kalman Filtering is another such powerful approach. In this paper, however, we wanted to directly show the raw data and their effects on the human toll using only graphical means.

3 FEDERAL RESERVE BANK

The Federal Reserve Bank (The Fed or the central bank of USA) is a very secretive organization. This secrecy is in its DNA right from the day it was formed in 1913. It is a private bank, not controlled by US government, as former Fed chairman says (Greenspan, 2009). The Fed also does not want to be transparent (King, 2010), a long held complaints from many economists.

All the banks are required by law to maintain a reserve deposit amount at the central bank. As of 2004, the total required reserve amount at Fed was down to $11.0 billion (TheFed, 2005, p. 32) from $46.1 billion in 2000. The Fed does not pay any interest for this deposit amount (Hubbard, 2002, p. 436). At the end of each day, the banks having low reserves borrow money from the banks with higher reserves. The banks charge interest for this exchange. This interest rate is known as the federal funds rate (FFR).

The FFR is an independent input (exogenous) variable to the economic system. The target value of this FFR is decided by the Federal Open Market Committee (FOMC) of the Fed. The minutes of FOMC (FOMC, 2010) confirms that. In the paper (Bernanke, 1992) the authors claim “In all cases we obtain plausible results which suggest that the Fed was purposefully manipulating the funds rate during the pre-1979 period – an observation that is consistent with what the Fed claims to have been doing.” Thus we can see that the capitalism, at its core, was never a free market economy, the FFR is not a market variable; it is set by the Fed.

The Fed controls how much money each bank can give as loans to their customers by controlling the reserve amount at the Fed. This is done by a parameter called reserve ratio, a single number, and decided arbitrarily by the Fed and it is not restricted by market condition. This reserve ratio is normally not changed. The total money that a bank can lend is controlled by a factor called money multiplier, which essentially is the reciprocal of the reserve ratio. This money multiplier is a parameter of the control system that can be used to fine tune the shocks in the economy. The Fed also sets the primary interest rate for the banks by FFR, which is controlled on a daily basis.

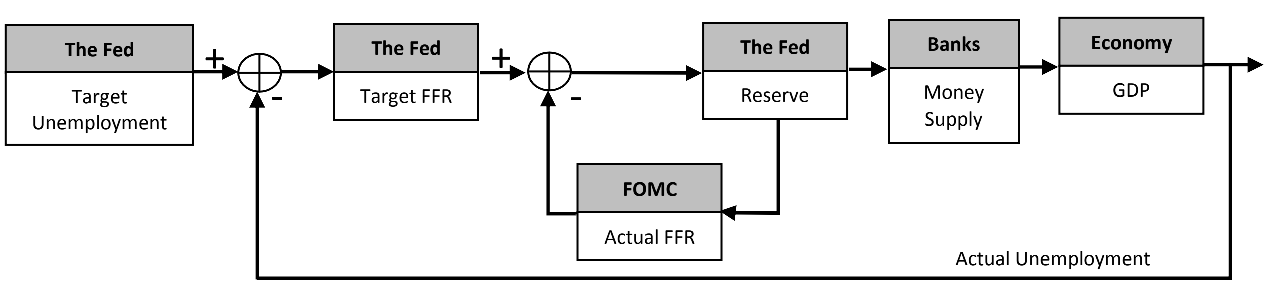

Fig. 1- FFR control policy

The paper (Modeste, 2002) explains how FFR controls the entire economy by giving the straight forward Keynesian logic – "an increase in the federal funds rate is expected to lead an increase in short-term interest rates as the cost of funds to lenders increases. With businesses and consumers responding to the higher interest rate by reducing their expenditures, economic activity is expected to fall, thereby, leading to an increase in the unemployment rate".

The financial system has been designed by the Fed, like a simple single input single output (SISO) control system as shown in Figure 1. So, it can be easily controlled by only one input variable, the FFR. Its output is the unemployment rate from the economy. This simplicity at the top of the pyramid generates the enormous power for the Fed.

The inner loop tracks the target FFR by open market operation for trading of government securities, which controls the reserve. This operation, guided by the FOMC, generates the actual FFR. When the actual FFR becomes equal to or very close to the target FFR the open market operation can stop. This inner loop defines the FFR and therefore the Reserve amount. The reserve in turn will define the money supply to the economy. The money supply controls the unemployment rate. The unemployment rate produced by the economy is compared with the target unemployment in the outer loop. The error in this outer loop is used to set the target FFR.

The government mandate for the Fed has few major flaws. The Fed is not required to maintain full employment (Bernanke, 2010). The law now says that the Fed will maintain maximum possible employment. This maximum number has not been defined either. The average salary of the bottom fifth has also not been defined. The Fed is also not mandated by the government to follow the free market economy.

Hidden among all these jargons has the most important power of the Fed - the ability to print money. It is the only bank that can print money, as much as it wants, whenever it wants, give it to anybody it wants, and is not accountable to anyone, not even the government.

4 FUNDS RATE, GDP, AND RECESSIONS

The Figure 2 shows the GDP graph from 1929 to 2009, and

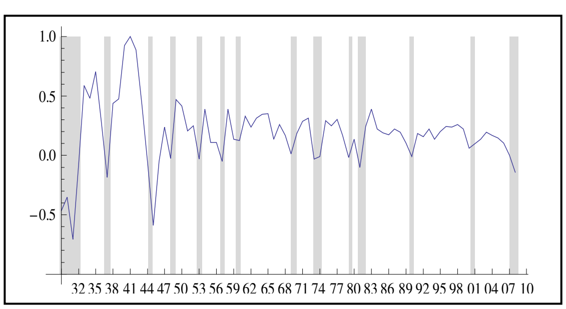

Fig.2 - GDP and Recession 1929-2009

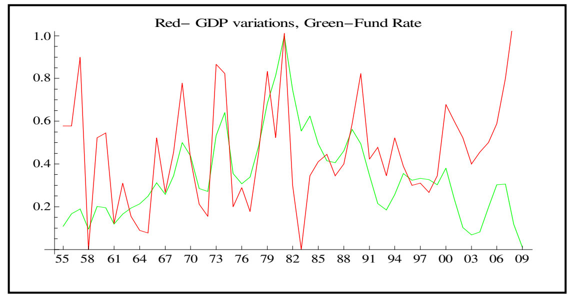

Fig.3 - GDP and Fund Rate 1955-2009

the data was taken from (NEA, 2010). The GDP graph is superimposed on the recession bands. The width of the bands defines the length of the recession period. This data was collected from (NBER, 2010). We can see that the growth rate goes negative before every recession period. The graph matches with many books and publications, for example (Desjardins, 2008).

The Federal Funds Rate data is taken from the Fed database (Fed, 2010). In Figure 3 we have plotted the normalized data of FFR and GDP variations. The GDP data was shifted left by two years to make the peaks match. We have also scaled the data using the following relation 0.8*(1-gdp) to graphically highlight the correlation. A delay or lag of 2 years in the GDP data produced a correlation of 0.8306.

Since we know from Section 3 that the funds rate is the driver, we can see from Figure 3 how it causes the GDP variations. Every time the funds rate goes high, the GDP goes low; this in turn causes the recession to begin as we can see from Figure 2.

The Figure 4 is another way to show the relationship of the funds rate and the recessions. Here we superimpose the variations in the FFR over the recession bands. The graphs show that every recession is created at the peak of the FFR values. The Fed keeps on increasing the funds rate until the recession begins as shown by the control system diagram in Figure 1. In (Dimitrov, 2006) the authors presented a graph similar to Figure 4 and confirm that the funds rate shows onset of two recessions during 1979-82. In (Belonga, n.d) the authors comment that the conventional wisdom is that funds rate goes up before recession and goes down after, with data between 1985 and 2009. Bernanke (1992) was the first to show graphs like Figure 4.

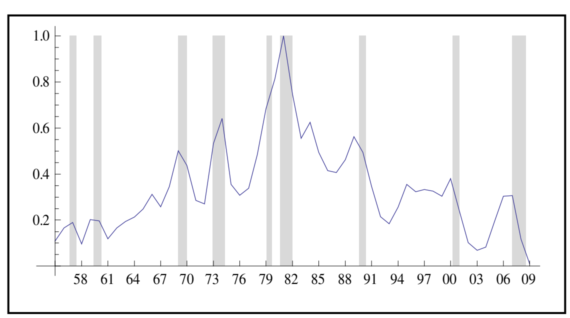

Fig.4 – Funds rate and Recession bands 1955-2009

The Figure 4 shows the underlying control method of FFR by the Fed. Using FFR the Fed can create the recessions whenever they want and they can also control the duration of the recessions. The graph also indicates that a sustained increase of funds rate will eventually cause the recession. During 80-82 it was necessary to increase the funds rate to a high value to cause the recession. On the other hand a small increase in FFR caused a long recession during 08-09 period. There are other non-financial dynamic characteristics in the economy that determine when the recession will start with respect to the FFR and how long the recession will continue. The built in inertia of the economy changes over time as the technology changes.

5 FUNDS RATE AND UNEMPLOYMENT

In this section we show with the data and their graphs that the central bank is systematically controlling the unemployment rate. The unemployment data is taken from Bureau of labor statistics of the US department of labor (DOL, 2010). The details of this data are given in the document (DOL, 2009).

We found that a left shift of three years for the unemployment data is ideal for these graphs, which gives a correlation coefficient of 0.92701. It is seen from the graphs, that a second and different delay after 1988 will give even better synchronization and hence higher correlation. The structure of the two graphs in Figure 5 is sufficient however, to show how the funds rate is affecting the unemployment and is serving the control mechanism of the central bank as shown in Figure 1. Again, it is quite surprising that this relationship, in Figure 5, was never explicitly pointed out, as far as we know, by any publications.

The Fed can destroy an economy very quickly and create large unemployment and transfer huge amount of wealth. But it cannot reverse the process to build the economy again within that same period. That is because the Fed is not involved in GDP creation. It can only supply the money and money alone cannot make the product. Lot of engineering, organizational effort, confidence, and moral are required for building the economy back. Thus the recession process and the subsequent destruction of economy can cause severe suffering for the people. It is very much like destroying a city by earthquake or a bomb, in a very short time like in minutes, but it takes years to rebuild the city.

It is ironic that the recession is not measured using the unemployment data. Instead it uses GDP. The government does not include the Wall Street gains in the GDP computation. The sales of stocks and bonds at the Wall Street are not counted in the GDP (Case, 1999, p. 135). Thus the Wall Street does not reflect unemployment or the GDP. Yet our government seems to feel very happy when the Wall Street is happy, ignoring the concern of millions of unemployed citizens.

Probably (Bernanke, 1992) was the first to suggest that the FFR as an exogenous variable. The paper (Balke, 1994) says that, using data before 1979, and using vector auto regression (VAR) method, it has been shown that the funds rate has “important predictive content for unemployment”. The paper (Thorbecke, 2000) explains that the Fed can control unemployment by manipulating federal funds rate. As the funds rate increases other interest rates also increase and thus the nations’ spending decrease. As spending declines employment declines as well. Thus when the Fed seeks to increase unemployment it increases the target funds rate. However, Thorbecke does not provide any numeric validation. The paper (Modeste, 2002) uses mathematical models to show that “there is a long run relationship between the federal funds rate and the unemployment rate”. Our results show, directly from the data, a very high correlation (0.92701) with consistency over the entire data length. The similarity in their co-movement is quite visible in the graphs of Figure 5.

6 TRANSFER OF WEALTH

We have taken the income data from US Census Bureau (USCB, 2010). The Figure 6 shows the income of the bottom fifth of the population. The graph clearly shows that their income is consistently going downwards since 1976. The graph occasionally went up for short period of time, like in 1967, ’73, ’94 etc. But it has an overall downward trend and every recession has a visible downward impact on the income. The next graph, Figure 7, shows the income of the top fifth of the population. It is clear that despite the recessions their income is growing persistently over all the years. Thus there is a truth in the statement that the rich is getting richer and the poor is getting poorer.

The above graphs confirm that the economic objective of the central bank is to transfer wealth from the poor to the rich.

Fig.5 – Funds rate and Unemployment

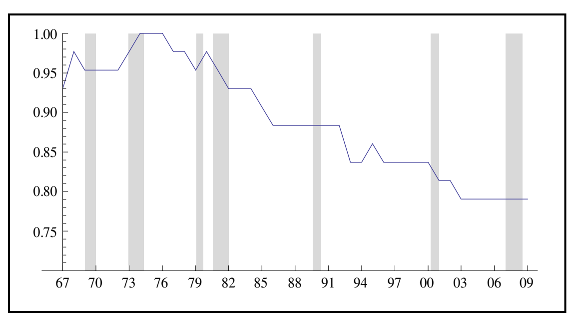

Fig.6 – Income of bottom fifth and Recession

This is achieved by doing all of the following things: (a) profiting, (b) interest charging, (c) printing money, and (d) creating unemployment. All of them essentially increase the bag of dollar bills without increasing the pot of gold. The LOC then helps to transfer the wealth.

To clarify, let us examine how profiting transfers wealth. Consider a company that manufactures writing pens at a total cost of $5 per pen. Now assume that the company sells it at $15 per pen making a profit of $10 per pen. Thus the cost of the pen for the CEO of the company is $5 but for you and me it is $15. Therefore every pen is taking away an extra $10 from all of us. This process of profiting helps to take money away from the people and to accumulate to the hands of a very small group of people creating inflation and transfer of wealth. The interest charging process is essentially the same activity also.

Inflation happens whenever money is accumulated in the hands of a smaller group. That is because they can pay more for the goods raising its price. Since the bag of dollar bills is tied one to one with the pot of gold by the LOC, money accumulation means gold accumulation i.e. transfer of wealth.

Because of unemployment, during a recession, a poor woman can become homeless very soon. And another rich person will become the new owner of that home thus transferring the wealth. The wealth cannot be destroyed according to the LOC, it can only be transferred. Large number of banks and businesses were forced to fail by the policies of the central banks, during the two great recessions of 1930s and 2008. Millions of people were made unemployed and homeless. And exactly the same amount (Bates, 2003) of wealth was transferred to the rest of the population by LOC. Thus recession is the best way to bulk transfer of wealth over a short period. Profiting and interest charging transfer wealth slowly and over longer time frame.

The recession is another way to keep the salary of bottom fifth at low rate. More you beat them with unemployment more vulnerable they will become and will be forced to work with lower salary. Thus wealth can be created with lower cost thus increasing profit. Note that the people at the bottom fifth really produce the wealth. In this sense the bottom fifth should be paid the highest salary in the hierarchy of the economic food chain.

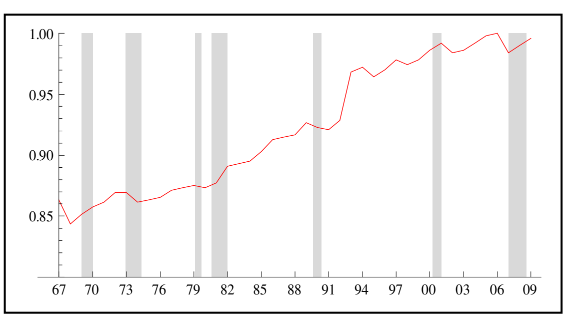

Fig.7 – Income of top fifth and Recession

The recessions are not natural laws of capitalism. Dr. Larry Bates, a banker and economists says (Bates, 2003) these recessions are precisely controlled, monitored, and can be predicted. We have explained that theory by Figure 1. The company (ECRI, 2004) has mastered the prediction method of business cycles. Many world governments consult ECRI to create their indices for predications of their recessions. ECRI can do so with an accuracy of two weeks.

Printing money is a very secret way to transfer wealth. US President (1801-1809) Thomas Jefferson wrote (Ritholtz, 2009, p. 15): ".. if the American people allow private banks to control the issuance of their currency, first by inflation and then by deflation, the banks and corporations that will grow up around them will deprive the people of all their property until their children will wake up homeless on the continent their fathers conquered." We can see form our graphs that this is happening exactly, recession after recession, in the United States, even after so many years.

We should understand that, inflation by printing money, as it is, cannot be bad. It becomes bad only when the excess money is allocated to a smaller group instead of the entire population thus forcing transfer of wealth to happen. When the money goes to the entire population, inflation happens but the purchasing power does not reduce, because it does not violate the LOC.

7 INFLATION AND TRANSPARENCY

It is said that the Fed has the dual policy to control both inflation and unemployment in an optimal way that is good for the economy. In reality that is not the case, as we have shown with the data. Its only objective is to transfer wealth to a very small number of people. In the process it makes people unemployed, creates inflation, and makes businesses including banks to fail.

Inflation is a process of increasing money supply (Hubbard, 2002, p. 744), violating the LOC. This process helps to transfer wealth, by increasing the share of the pot of gold. Keynes (Keynes, 1920, p. 235-236), a father of economic theories, says – "By a continuing process of inflation, governments can confiscate, secretly and unobserved, an important part of the wealth of their citizens. By this method they not only confiscate, but they confiscate arbitrarily; and while the process impoverishes many, it actually enriches some. … The process engages all the hidden forces of economic law on the side of destruction and it does it in a manner which not one man in a million is able to diagnose". We should recognize that profiting and interests charging are also inflation in disguise.

How much money the Fed is printing is never known and will never be known. It is the only body that can print money and allocate to anyone it wishes. The Bloomberg news claims (Pittman, 2009) in a law suit against the Fed, that the Fed spent $12.8 trillion as the bailout money. The GDP during 2008 was $14.2 trillion. Thus we have a very high hidden inflation. If you do not know the amount of money present in the economy then you cannot compute the real inflation. All the inflation data presented by the government are therefore fictitious. All our theories on economics, like Phillips curve, supply-demand, etc., will be wrong too.

In the absence of transparency, as seen by the Fed's refusal to provide information to Bloomberg, no free market economy can exist. Roger (Garrison, 2009) writes – "Of all the losses suffered during the current recession [of 2008], one of the most notable (and well deserved) is the loss in reputation suffered by today's macroeconomics textbooks". This is indeed true as we have also pointed out earlier that the Fed controls the FFR completely independently, destroying the concept of free market theory. If the Fed violates it then why do you think other banks and the CEOs will not do the same?

In the following section we will see if this problem of transferring wealth by capitalism can be solved.

8 MONEYLESS ECONOMY

There is a group of researchers on moneyless economy, like in (Nicolas, 2007), which proposes economic policies without consideration of monetary aggregates. But our subject in this section is different. In the paper Ross (Starr, ND) discusses a moneyless economy, without any price attached to any product or labor, and shows how an existing style market can be implemented. In this section we present a moneyless economy (MLE), similar to Ross, but with a different philosophy.

It is well known that the money is free for the Fed. It is a private bank and only it can print money without any restrictions, at anytime, and by any amount. Since the money is free for the Fed, it should be free for everybody. We should not have to pay it back; there should not therefore be any debt or deficit. Thus the Fed has artificially created the taxation, periodic payment, interest rate etc. At the core of capitalism then we really have a free or MLE now.

Let us examine the status of money today. We are all dealing with electronic money these days. Our employment checks are deposited electronically by our employers in our banks. We buy things using our credit cards. We pay the bills using our computers. Thus the money is just a number in some database on some computers. That number goes up and down and controls our life styles. Now we ask do we need that number to control us.

Instead of trusting that number on a computer why not we all trust ourselves and work for free? We go to our work places and work just like we are doing it now. The only difference is that we do not get paid. The computer number changes to 40 hours. Government tracks this number. We all become dedicated servant for the society, for the people, for the government, and finally for the god for 40 hours per week every week. Note that this means only meaningful work for the society will be required. In return we get everything we want for free.

We go to a store and buy everything we want, but there is no need to pay, because there is no money. If we want to live in a big house, we hire a contractor; he builds it free for us. If we want to travel; we book the flight, and travel free, stay in a hotel free. Everything will be free because everybody is working free. You can enjoy any kind of life style you want. MLE is thus not socialism. People will still have to work otherwise there will be no food or shelter.

Buddha and Gandhi have established a method of austerity and the self control of mind, body, and soul to reduce the need for money. This is a solution at the individual level. Milton Friedman has proposed the elimination of the central bank. US president Jefferson proposed printing money by the government. Both Friedman and Jefferson essentially said the same thing; and their approach gives a global solution to our poverty. But our approach of MLE is more profound and provides cleaner solution to all our problems.

This MLE will eliminate environmental pollution and the wars. It will eventually kill the pollution of our souls by removing greed, corruption, violence, cheating, and lying. MLE will eliminate poverty from the world permanently. The MLE will allow us to create products that we really need and nothing, like cigarettes, can be imposed on us by the investors. There will be no investment banking system. In fact the whole financial system including the central banks will not be required any more. We will have more people working for real benefits of the society.

It may appear that the MLE model ignores the value of education. Many people who introduced technology, like Thomas Edison, Benjamin Franklin, Wright Brothers, Bill Gates, and Steve Jobs etc. were not formally educated. Thus education is not necessary to create a new technology.

In a MLE only those people who love education and knowledge will pursue such activities. The concept of hard and easy work will be replaced by love for work. There will be always people who will aspire for knowledge and will go for anything it takes to achieve that wisdom, the history of mankind demonstrates that.

In MLE, since you get free whatever you want, there is no need for a merit evaluation system. You cannot and should not compare two different persons or two different jobs. It will be like comparing apples and oranges.

9 CONCLUSIONS

In this paper we have shown, (using the law of conservation, public data, and the publications of previous researchers), how the Fed manipulates the economy using the single variable, the federal funds rate, to create recessions and unemployment, thereby transferring wealth and accumulating it in few hands. This concept highlights that the poverty is created by the central banks and is not a natural phenomenon. We have proposed to implement the moneyless economy to eliminate poverty. However we have not been able to show how to counter the force of money power to make that transition happen. That is, we haven't answered the question the Nobel Laureate Milton Freidman in economics asked - "One unsolved economic problem of the day is how to get rid of the Federal Reserve".

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